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October 16, 2000

RULES PROCESSING TEAM

OCT 16 2000

Department of the Interior
Minerals Management Service
Mail Stop 4024
381 Elden Street
Herndon, Virginia 20170-4814

Attention: Rules Processing Team

RE: Minerals Management Service Proposed Rule, Outer Continental Shelf Oil and Gas Leasing. 65 FR 55476-55489, September 14, 2000.

Dear Sir or Madam:

Texaco Exploration and Production Inc. (Texaco) appreciates the opportunity to provide comments on the above referenced Minerals Management Service (MMS) proposed rule. Texaco has actively participated in the OCS program since its inception over 40 years ago and we continue to be a strong advocate of prudent exploration and development of our nation's offshore oil and natural gas resources. Texaco is one of the largest leaseholders in the Gulf of Mexico with numerous non-producing leases located in deepwater. Reasonable and workable regulations are a key to the continued success of the oil and natural gas business in the United States especially in the few frontier areas currently accessible to industry.

Under separate letters MMS has received comments from the National Ocean Industries Association, American Petroleum Institute, Domestic Petroleum Council, Independent Petroleum Producers Association and the US Oil and Gas Association. Texaco concurs with the comments and recommendations provided in these letters. In addition, Texaco submits for MMS' consideration the following answers to the questions asked in the preamble of the proposed rule and some selected comments on the rule itself.

Future Royalty Suspensions

- What factors should we consider, and how should we evaluate these factors, when we choose water depths beyond which bidders still need leasing incentives in the GOM?

Two underlying principles should be considered as MMS develops its future royalty relief program. The first principle deals with the concept of incentives to entice the continued investment by industry in the exploration and development of natural resources in the United States. With very little public OCS land available for leasing, and the current administration's actions over the last eight years restricting access to promising unexplored or under-explored areas, there appears to be little governmental support for the continuation of a strong domestic upstream industry in the United States. The first component of royalty policy should be an incentive to industry to continue to invest its

limited risk dollars in the U.S. Without this encouragement, more risk capital most likely will continue to leave the U.S. for foreign investment.

The second principle deals with the "need" for incentives as stated in this particular question. The investments in deepwater are considerable and risks of financial loss significant. Sharing those risks is reasonable when all parties stand to benefit from the investment. Royalty relief provides a form of financial risk sharing which many OCS Lessees believe is needed to continue exploring in the Gulf of Mexico. A royalty relief policy which includes both an "incentive" and "need" component would be the most beneficial to industry.

- What elements besides water depth should we consider, and how should we consider them, when deciding how much royalty suspension to offer on new leases?

Besides water depth, MMS should consider the cost to drill and develop new discoveries in deepwater including infrastructure development. In addition, the development of new technologies should be encouraged to stimulate efficient and safe production in deepwater. Quantifying the new technology element may be difficult and strictly subjective.

- Which of the following leasing policies would encourage more domestic investment, given equal expected rates of return, and why would it do so? One offering a: (a) Substantial royalty suspension volume coupled with higher than normal royalty rates (*e.g.*, 20 percent) for additional production between specified cumulative production volumes; or (b) Modest royalty suspension volume but with only normal lease royalty rates for production above the royalty suspension volume?

Modest royalty suspension volumes with normal lease royalty rates would be preferred given only the choices listed in this question. The key to this preference is a Lessee's ability to request and be granted from MMS "discretionary" suspension volumes to supplement the automatic suspension volumes granted in the lease. These discretionary volumes would need to be based on companies' minimum economic investment thresholds that could be different from MMS perceived economic rates of return.

- Does the likely increase in bid levels and shift of uncertainty from government to industry that are associated with royalty suspension adversely affect small companies relative to large companies?

At this time, with the exception of OCS Lease Sale 181 (Eastern Gulf of Mexico), it is not anticipated there will be an increase in bid levels as previously experienced in the mid-1990s after inception of the Deepwater Royalty Relief Act (DWRRA). Assuming this belief is correct, it is unknown how royalty suspension will adversely affect small companies relative to large companies.

<u>**Lease-Based Royalty Suspension**</u>

- Do you agree with our observation that a lease-based royalty relief program, providing a guaranteed royalty suspension volume to each lease regardless of which field it overlies, is preferable to a field-based royalty relief program, providing a royalty suspension volume to be claimed by the earliest producers on a field?

A lease-based approach is preferable to the current field based royalty relief program. However, implementing a lease based royalty relief program intermixed with a field based program has the potential of creating substantial uncertainty between Lessees with leases containing differing royalty suspension provisions located in the same field. For leases subject to royalty suspension issued adjacent to or contiguous to leases currently located in an existing field, MMS needs to establish a clear mechanism for determining what leases are located in which fields as soon as reasonably possible. If MMS, prior to a Lessee drilling a discovery well, makes a preliminary determination as to the potential field a lease would be subject, some of the uncertainty encountered with the existing program could be eliminated. After a well is drilled, a final field determination could be made. Under a program allowing pre-field determinations, at least the Lessees in the field would have a chance to evaluate the effect of their lease being included in an existing field prior to making drilling or development decisions.

- Do you share our expectation that royalty suspension volumes tailored to a typical tieback development will promote bidding and exploration in the deep-water areas that will be available in the next several years?

Exploring with the intent of utilizing subsea production system tiebacks to existing infrastructure at this stage in the development of deepwater adds an additional element of risk to a Lessee's ability to develop a small non-stand alone project. Infrastructure development in the deepwater Gulf of Mexico is in its infancy. Depending on someone else's facility to handle your production is very risky. MMS position on phased development when considering current Suspension of Production policy (5-year limitation) adds another element of uncertainty to a subsea tieback scenario. It is not believed that royalty suspension volumes tailored to a tieback development program will promote bidding and exploration. In most cases stand-alone developments are the primary focus by industry in unexplored or under-explored areas of the Gulf.

- Is it reasonable to assume between 2 and 3 leases per field will be developed as a tieback?

It is not reasonable to assume two to three leases per field will be developed as tiebacks. This is a totally subjective assumption unsubstantiated by the current state of the industry in developing deepwater. It is suggested MMS not assume, as a general rule, two or three leases per field will be developed as tiebacks.

- What benefits would occur for bidders and lessees if we modified the volume suspensions offered on new leases every 3 years as opposed to more frequently?

Minimizing uncertainty in the oil and natural gas exploration and development business is critical to making sound business decisions. Establishing an MMS policy that is predictable will help eliminate some of the uncertainty in the entire process. In addition, it will assist in companies' ability to plan for future leasing decisions. It is recommended MMS give consideration to implementing a royalty suspension leasing policy wherein suspension volumes for newly issued leases are consistently applied for a least three years of lease sales.

Rental Payments

- What effect, if any, would rental obligations during periods of royalty-free production have on the way firms plan and manage a project?

Annual maintenance payments (rentals or minimum royalties prior to production) on OCS leases are common and expected. Once production has commenced however, these payments are replaced with royalty payments (unless royalty payments do not equal to the minimum royalty then the difference becomes due to MMS). It is recommended that once production commences, until the royalty suspension volumes have been produced, no annual maintenance payment be due.

- Do you agree with our observation that, given current costs, technology and development options in deep water and the dynamic nature of these factors, the program would benefit from periodic adjustments at the time of lease sales in price thresholds for new leases?

As stated above, predictability and reduction of uncertainty are critical in the continued exploration and development of deepwater. Establishing long term policy is preferable. Deepwater projects are long lead-time events. In some cases, it may take over five years from discover too first production. Advances in technology and fluctuations in prices are unpredictable. It is recommended the MMS give consideration to establishing a royalty relief policy that is long term and not subject to short term modifications.

- Do you believe that adjustments in royalty obligations, other than retroactively for the previous calendar year are desirable? If so, why and what is the nature of the preferred adjustments?

As stated above, predictability and certainty are preferred. Adjustments in royalty obligations are uncertain and difficult to plan for. Royalty adjustments are not desirable.

- Do you agree with our preliminary findings that the applicable price thresholds should be 10 to 15 percent below the levels currently applicable under the Act, *e.g.*, $28 rather than $31 per barrel for oil, and $3.45 rather than $3.90 per million British thermal units?

The application of price thresholds as a mechanism to suspend royalty holidays is reasonable. The oil and natural gas prices at which these suspensions become effective should be relatively high. Product prices in the oil and natural gas industry have fluctuated significantly over the past thirty years. There are no guarantees product prices will stay high or low. The one element of price that is predictable is that it will change. The current price threshold adjusted for inflation is reasonable and should continued to be used.

Change to Royalty Suspension Policy for Eligible Leases

One final item of note is a proposed requirement that a lessee with eligible leases issued with a royalty suspension volume notify the MMS Regional Supervisor for Production and Development before starting production. Does this additional notification step impose any meaningful burden on lessees?

At this time the answer is "No."

Comments on the Proposed Rule

30 CFR 218.151(a) – "Rental Fees"

It is Texaco's understanding that when MMS drafted the regulations to implement the provisions of the Deepwater Royalty Relief Act (DWRRA) it inadvertently failed to address the effect of royalty suspension on minimum royalty payments due on leases determined capable of producing in paying quantities pursuant to 30 CFR 250.115 prior to first production. An annual maintenance payment historically has been due on an OCS lease prior to first production. This payment has been classified either a rental or minimum royalty depending on whether or not the lease in question had been drilled and a well discovering hydrocarbons in paying quantities was located on the lease. Clarification of the regulations to eliminate any confusion of whether or not this maintenance payment is due prior to first production is encouraged.

30 CFR 260.120 (et al) Royalty Suspension Leases

Under 30 CFR 260.120,121,122,123 & 124 of the proposed rule, MMS has drafted the regulations limiting its granting of discretionary royalty relief based solely on volumes. Under 43 U.S.C. 1337(a)(1)(H), the Secretary of the Interior may suspend royalties by time period, volume, or value of production. It is recommended MMS consider either in this or future rulemakings to codify its regulatory authority to grant royalty relief in terms of time or value as well as in terms of volume. Events in the future may necessitate the use of other forms of discretionary relief. Modifying the proposed rule or drafting a new rule in the near future would give MMS the flexibility to utilize its current authority should the need arise.

30 CFR 260.121(b)(3) – 87 Minutes 30 Degrees West Longitude

Under Section 260.121(b)(3) of the proposed rule, the MMS states that discretionary royalty relief for post November 2000 leases is available for some leases that meet certain criteria, including the requirement that the lease must lie wholly west of 87 degrees, 30 minutes west longitude. Under 43 U.S.C. 1337 (a)(3) of the OCS Lands Act, the Secretary of the Interior has the discretionary authority to reduce or eliminate royalties for producing or non producing leases in the Western and Central Planning areas of the GOM and for whole blocks in that portion of the Eastern Planning Area of the GOM lying west of 87 degrees, 30 minutes west longitude. This discretionary authority has no time restriction. Under 43 U.S.C.1337 (a)(1)(H), the Secretary, as part of the bidding process and the awarding of leases, has the discretion to award leases on the basis of a cash bonus bid … "and with suspension of royalties for a period, volume, or value of production determined by the Secretary…." No geographic restrictions apply to leases issued under this particular bidding system. The DWRRA does not specifically prohibit the MMS from granting discretionary royalty relief on deepwater leases issued in areas outside of "west of 87 degrees, 30 minutes west longitude. Texaco believes MMS has narrowly interpreted the geographic restriction described above in implementing its discretionary royalty relief and encourages MMS reconsider this interpretation and revise 30 CFR Sec. 260.121(b) by deleting "(3) Wholly west of 87 degrees, 30 minutes West longitude."

30 CFR 260.130 – Criteria Used by MMS for Selecting Bidding Systems

In a review of this particular subsection of the proposed rule it appears MMS may be considering the use of multiple bidding systems during a single lease sale. If in fact this were the case, the lease sale process would become increasingly complex, uncertain, and susceptible to litigation and delays in development. Section 260.130 appears to imply MMS could use multiple bidding systems by tract in a given lease sale. If this is not intended, the language should be clarified. If in fact MMS intends to apply various bidding systems to different tracts in a single lease sale, it should be recognized that such a policy could potentially increase the possibility of mistakes being made during the bidding process.

30 CFR 260.303 – Joint Bidding Requirements

It can be interpreted that, as currently worded, the proposed rule would prohibit post-lease sale agreements between restricted bidders (e.g. Farm-ins, Farmouts, Unitization, etc.) that are currently allowed in the OCS. The rule should be clarified to permit agreements between persons on the restricted bidders list that are entered into after the lease sale. Section 260.303(d) could be clarified by inserting after the word "agreement" the words "prior to a lease sale."

Texaco again wants to express its appreciation at being given the opportunity to comment on the referenced proposed rule. Should there be any questions regarding our responses to MMS' questions or the comments stated above, do not hesitate contacting the undersigned at the address or phone number in the letterhead.

Yours very truly,

James C. [signature]

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